

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: General- Benchmark Modification Policy

ITEM NUMBER: 7

ATTACHMENT(S): 1

ACTION: X

DATE OF MEETING: May 3, 2000

INFORMATION: _____

PRESENTER(S): PCA, Allan Emkin
Patrick Mitchell

EXECUTIVE SUMMARY

At the April 2000 Investment Committee meeting, after written and oral presentations regarding a review of tobacco reports, staff was directed to provide a Benchmark Modification Policy for consideration. In preparation of this agenda item it was determined that there was no formal policy regarding the selection of benchmarks.

The purpose of a benchmark, as identified in the Investment Management Plan, is "To facilitate the periodic reporting to the Investment Committee and to provide a relative measure to gauge success, custom performance benchmarks are approved by the Board." In this agenda item both a Benchmark Policy and a Benchmark Modification Policy are presented for review.

BENCHMARK POLICY

1. The approved performance benchmarks are used in the asset allocation process for modeling purposes. The approved benchmarks are contained in the Investment Management Plan.
2. There are four characteristics identified as desirable in the selection of an appropriate benchmark.
 - (A) Unambiguous -- The names and weights of the securities in the benchmark should be clearly defined.
 - (B) Investable -- The securities contained in the benchmark should represent tradable positions. Ideally, the benchmark should be constructed with low turnover (companies should not change too much over time) to minimize transactions costs.

- (C) Measurable -- The pricing of the benchmark should be transparent making it possible to track the benchmark's performance. The benchmark will, whenever practical, be calculated independently and available to the public on a daily basis (applies to publicly traded asset classes only). Appropriate -- As part of the investment planning/policy process the Investment Committee will adopt an asset class benchmark (reference portfolio) that reflects the broad risk and return characteristics of that asset class. The benchmark will be the reference portfolio against which the aggregate active and passive portfolios within that asset class will be measured.
3. As a matter of practice the approved benchmark will be reviewed on a periodic (annual) basis to assure that it continues to reflect the risk/return characteristics of the asset class in a cost-effective manner. Strategic asset allocation assumptions will be based upon expected risk, return, and correlation coefficients of the approved benchmark.

BENCHMARK MODIFICATION POLICY

1. Asset class benchmarks may be modified when it is in the economic interest of the System.
2. Benchmark modification indicators are identified as:
 - A. When a more cost efficient (expenses such as trading costs or transaction fees) alternative is available that captures the risk return characteristics of the asset class.
 - B. When an industry or sector (component) of the benchmark is exposed to economic risks that are of such a degree that the future economic viability of that industry or sector is in doubt. Specific indicators are:
 - (1) The industry, not an individual company, shares common exposure to product liability judgements (including, but not limited to, potential judgements involving overwhelming punitive damage awards), settlements, and ongoing litigation that have the potential to exceed the industry's net worth.
 - (2) Significant threat of industry-wide bankruptcy filings.
 - (3) Regulatory and/or legislative actions that have the potential to substantially impair industry-wide earnings.
 - (4) Policy actions in the institutional investor community that, in aggregate, have the potential to have a deleterious effect on industry-wide share prices.

- C. In the event that at least two of the above-referenced indicators are evidenced the staff or a member of the Investment Committee may bring the matter before the Investment Committee for consideration of due diligence. If approved by the Investment Committee due diligence will include:
- (1) Analysis by the staff and/or third-party experts that the indicators are evidenced and have the potential to adversely impact the specific industry.
 - (2) Identification and listing of the individual companies in the specific industry based upon the definition adopted by the Investment Committee.
 - (3) Analysis of the impact the benchmark modification is expected to have upon total portfolio risk/return characteristics.
 - (4) Analysis of the expected costs associated with implementation of the benchmark modification.
 - (5) A timetable for review of the benchmark modification.

RECOMMENDATION

After reviewing the written material and panel discussion presented in the April 5, 2000 Investment Committee, staff and PCA recommend Investment Committee approval of the Benchmark Policy and the Benchmark Modification Policy by adopting the resolution contained in Attachment 1.

PROPOSED
RESOLUTION OF THE
CALIFORNIA STATE TEACHERS' RETIREMENT BOARD
INVESTMENT COMMITTEE

Subject: Benchmark Policy and Benchmark Modification Policy

Resolution No.

WHEREAS, the Investment Committee of the California State Teachers' Retirement Board is responsible for recommending to the Board, investment policy and overall investment strategy; and

WHEREAS, the Investment Committee has received and reviewed the written Benchmark Policy and Benchmark Modification Policy and has heard oral presentations from Consultant and Staff; and

WHEREAS, the Consultant and Staff have recommended the adoption of the Benchmark Policy and the Benchmark Modification Policy; Therefore be it

RESOLVED, that the Investment Committee of the California State Teachers' Retirement Board adopts the Benchmark Policy and the Benchmark Modification Policy.

Adopted by:
Investment Committee
on May 3, 2000

James D. Mosman
Chief Executive Officer